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Arizona Corporation Commission

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF THE
ARIZONA ELECTRIC DIVISION OF CITIZENS
COMMUNICATIONS COMPANY TO CHANGE THE
CURRENT PURCHASED POWER AND FUEL
ADJUSTMENT CLAUSE RATE, TO ESTABLISH A
NEW PURCHASED POWER AND FUEL
ADJUSTMENT CLAUSE BANK, AND TO
REQUEST APPROVED GUIDELINES FOR THE
RECOVERY OF COSTS INCURRED IN
CONNECTION WITH ENERGY RISK
MANAGEMENT INITIATIVES.

Docket No. E-01032C-00-0751

IN THE MATTER OF THE APPLICATION OF
CITIZENS COMMUNICATIONS COMPANY,
ARIZONA GAS DIVISION, FOR A HEARING TO
DETERMINE THE FAIR VALUE OF ITS
PROPERTIES FOR RATEMAKING PURPOSES,
TO FIX A JUST AND REASONABLE RATE OF
RETURN THEREON, AND TO APPROVE RATE
SCHEDULES DESIGNED TO PROVIDE SUCH
RATE OF RETURN.

Docket No. G-01032A-02-0598

IN THE MATTER OF THE JOINT APPLICATION OF
CITIZENS COMMUNICATIONS COMPANY AND
UNISOURCE ENERGY CORPORATION FOR THE
APPROVAL OF THE SALE OF CERTAIN
ELECTRIC UTILITY AND GAS UTILITY ASSETS IN
ARIZONA, THE TRANSFER OF CERTAIN
CERTIFICATES OF CONVENIENCE AND
NECESSITY FROM CITIZENS COMMUNICATIONS
COMPANY TO UNISOURCE ENERGY
CORPORATION, THE APPROVAL OF THE
FINANCING FOR THE TRANSACTIONS AND
OTHER RELATED MATTERS.

Docket No. E-01933A-02-0914


Docket No. E-01032C-02-0914

Docket No. G-01032A-02-0914

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RESPECTFULLY SUBMITTED this 21st day of April, 2003.

day of April, 2003.



Scott S. Wakefield
Chief Counsel

1 AN ORIGINAL AND
2 TWENTY-ONE COPIES
3 of the foregoing filed this 21st day of
4 April, 2003 with:

5 Docket Control
6 Arizona Corporation Commission
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8 Phoenix, Arizona 85007

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TESTIMONY
OF
MARYLEE DIAZ CORTEZ

ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE

APRIL 21, 2003

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1 **INTRODUCTION**

2 Q. Please state your name, occupation and business address.

3 A. My name is Marylee Diaz Cortez. I am a Certified Public Accountant. I
4 am the Chief of Accounting and Rates for the Residential Utility Consumer
5 Office (RUCO) located at 1110 W. Washington, Suite 220, Phoenix,
6 Arizona 85004.

7
8 Q. Please state your educational background and qualifications in the field of
9 utility regulation.

10 A. Appendix I, which is attached to this testimony, describes my educational
11 background and includes a list of rate case and regulatory matters in
12 which I have participated.

13
14 Q. What is the purpose of your testimony?

15 A. The purpose of my testimony is to discuss and provide comment on an
16 agreement entered into between the Commission Staff, UniSource, and
17 Citizens (the "Parties"). The Parties' agreement pertains to all matters
18 currently pending in Docket Nos. G-01032A-02-0598 ("Gas Rate Case"),
19 E-01032C-00-0751 ("PPFAC Case"), and E-01933A-02-0914, E-01302C-
20 02-0914, G-01302C-02-0914 ("Sale and Transfer Case") (collectively the
21 "Consolidated Cases"). The terms of the Parties' agreement are
22 contained in a document that was filed on April 1, 2003 entitled
23 "Settlement Agreement UniSource Energy Corporation's Acquisition of

1 Citizens Communications Company's Gas and Electric Utility Assets".
2 (settlement agreement")
3

4 Q. Was RUCO a party to the discussions and negotiations that led to the
5 Parties' agreement?

6 A. No.
7

8 Q. Has RUCO had an opportunity to review the terms of the Parties'
9 settlement agreement?

10 A. Yes.
11

12 Q. Do you believe that the settlement resolves the issues of the Consolidated
13 Cases in a fair and unbiased manner?

14 A. For the most part, yes. There is much to be liked in the settlement
15 agreement. It goes a long way to resolve many issues that have arisen
16 as a result of the failure of energy markets to develop, and to mitigate the
17 adverse impacts of dysfunctional energy markets.
18

19 **The Electric Properties**

20 Q. Please discuss the some of the issues have arisen as a result of recent
21 events concerning Citizens' electric properties.

22 A. Due to dysfunctional electric markets during the 2000 to 2001 time frame
23 that drove the cost of power to unprecedented highs, Citizens electric

1 division has accrued a liability of approximately \$135 million in
2 unrecovered power costs. In the PPFAC case, Citizens had sought
3 recovery of these costs through its Purchased Power and Fuel Adjustor
4 Clause ("PPFAC"). Recovery of the unrecovered power costs would result
5 in an approximate 45% increase in customers' rates.
6

7 Q. How does the settlement agreement mitigate this situation?

8 A. As part of UniSource's purchase of the Citizens gas and electric properties
9 UniSource has agreed to forfeit any right to recover any of the \$135 million
10 electric power cost liability, and hold ratepayers completely harmless from
11 the impacts of the dysfunctional power markets of 2000 and 2001. This
12 term of the agreement also has the effect of reducing generation stranded
13 costs to zero.
14

15 Q. Does this mean that Citizens electric customers will experience no change
16 in rates?

17 A. No. Although Citizens' power is now supplied on a fixed rate contract,
18 which protects customers from market fluctuations, the fixed cost of the
19 power in the contract exceeds the cost of power that is embedded in
20 current electric rates. Pursuant to the terms of the PPFAC, the
21 incremental cost generally is recoverable through the PPFAC. This
22 incremental cost will increase electric commodity rates per kwh by
23 \$0.01824, or approximately 22%.

1 Q. If the electric properties did not transfer to UniSource, would Citizens
2 ratepayers still experience a rate increase?

3 A. Yes. The fixed cost of the power is the same whether Citizens retains
4 ownership of the electric operations or transfers them to UniSource.
5 Because Citizens, as yet, has not flowed through the fixed contract price
6 to ratepayers, a 22% increase for the going-forward cost of power would
7 still be necessary, absent the sale to UniSource. The advantage of the
8 settlement agreement is that the necessary increase is limited to the going
9 forward incremental cost of power and does not include recovery of the
10 \$135 million liability. Absent this agreement the rate increase would be
11 45% rather than 22%.

12
13 Q. What other terms of the settlement agreement benefit Citizens' electric
14 customers?

15 A. The electric customers will experience a permanent write down of
16 \$93,624,000 in electric rate base. As a result, in future rate cases the
17 level of investment for which UniSource is allowed to recover and earn a
18 return will be \$93.6 million less than it otherwise would be in Citizens'
19 hands. The reduction in annual electric revenue requirement as a result of
20 this write down is approximately \$17 million.

21
22 The agreement also provides for a three year rate moratorium for electric
23 customers. UniSource is precluded from seeking a rate increase during

1 this time period. The agreement is therefore beneficial to electric
2 customers by providing assurance of rate stability.

3
4 The agreement also requires UniSource to negotiate in good faith with
5 Pinnacle West for more favorable terms in the purchased power contract.
6 To provide an incentive for UniSource to seriously undertake this
7 endeavor, the agreement provides for a 60/40 sharing between ratepayers
8 and shareholders of any savings realized through the renegotiation. The
9 contract savings would serve to directly reduce the required 22% rate
10 increase through the PPFAC.

11 12 **The Gas Properties**

13 Q. Please discuss recent events that have impacted Citizens' gas properties.

14 A. During the same time frame that the electric industry was experiencing
15 large price spikes in the cost of power, natural gas prices jumped also. As
16 a result of these large increases in natural gas prices, Citizens was
17 required to significantly raise its PGA rate in the late fall of 2001. While
18 gas prices have subsequently declined from these highs, other pressures
19 have been brought to bear on the gas rates, which include the conclusion
20 of the gas "build-out" program, the expiration of the higher gas rates for
21 "build-out" customers, and as well as general inflationary pressures since
22 the last gas rate case in 1995. These events coupled with a request from

1 the Commission that Citizens file a rate case by June 2002, resulted in
2 Citizens application for an approximate increase in rates of 29%.

3
4 Q. How does the settlement agreement mitigate this situation?

5 A. UniSource has agreed to a lesser rate increase of 20.9%. Again, as with
6 the electric properties, UniSource has agreed to a rate base write down of
7 approximately \$32 million. The reduction in annual gas revenue
8 requirement as a result of this write down is approximately \$5.5 million.
9 This will serve to mitigate the need for future rate increases.

10
11 The agreement also provides for a rate case moratorium of three years,
12 which will facilitate near term rate stability. UniSource also commits to the
13 maintenance and continuation of current safety and quality of service
14 standards.

15
16 **The Overall Transaction**

17 Q. Beyond the mitigation of the gas and electric rate increases what other
18 benefits will be realized from the sale and transfer transaction?

19 A. Certain aspects of the sale and transfer itself, as well as specific
20 provisions in the settlement agreement provide benefits to ratepayers.
21 They are as follows:

- 1) A plan for operational consolidation, or in the alternative coordination of operations of the Santa Cruz electric division with the TEP electric system;
- 2) Guaranteed building of equity in acquired properties via a moratorium on the issuance of dividends in excess of 75% of earnings until such time as equity investment reaches 40%;
- 3) Required maintenance of quality of service and safety standards;
- 4) Ratepayers to be held harmless from any excess transaction costs resulting from any delays in the transfer process;
- 5) Potential for economies of scale resulting from a common ownership of the Citizens gas and electric properties with the TEP electric properties; and
- 6) Increased potential for renegotiation of the Pinnacle West power supply contract to more favorable terms.

RUCO'S POSITION

Q. Has RUCO joined Staff, Citizens, and UniSource as a signatory to the settlement agreement?

A. No. Despite all the benefits and mitigation of prior adverse events provided for in the settlement agreement, RUCO is unable to sign the agreement as it now reads.

1 Q. Why?

2 A. Staff did not allow RUCO to participate in the negotiation of this
3 settlement. As a result, the agreement reflects a resolution of the utilities'
4 and the Commission Staff's concerns. In large part the Parties concerns
5 parallel RUCO's concerns, and thus are resolved by the agreement.
6 However, RUCO has some concerns that are not addressed by the
7 agreement.

8
9 Q. What are those concerns?

10 A. While the settlement goes a long way in mitigating the adverse rate
11 impacts of prior events, it still has the unfortunate effect of resulting in rate
12 increases for both the Citizens electric and gas customers of just over
13 20%. Even though these increases are much lower than would be absent
14 the proposed transaction and settlement agreement, a 20% increase is
15 still substantial. While RUCO recognizes the historical circumstances
16 contributing to the need for the increases, at the same time RUCO
17 recognizes the need to keep customers rates relatively affordable.

18
19 **RUCO'S RECOMMENDATION**

20 Q. What modifications and/or additions could be made to the settlement
21 agreement to address RUCO's concerns?

22 A. The following modifications to the settlement agreement would address
23 RUCO's remaining concerns:

- 1) Increase electric Demand Side Management ("DSM") expenditures in the newly acquired service territory from the current level embedded in rates of \$175,000 per year to \$1,000,000 a year¹;
- 2) Modify Part D, paragraph 28, of the settlement agreement to set the sharing of any savings realized through the renegotiation of the Pinnacle West contract to reflect 10% to UniSource and 90% to electric ratepayers.

Q. Please explain why with these additions/modifications RUCO could support the settlement agreement as consistent with the public interest.

A. The increased funding of electric DSM programs will provide ratepayers with the tools to practice conservation of electric power and to control their energy usage. RUCO recognizes, that while arguably unavoidable, a 20% rate increase is significant and will create hardships for certain customers. The good news, however, is that the 20% increase is embedded 100% in UniSource's commodity rate. Thus, customers have the ability to mitigate the magnitude of the rate increase through reduced consumption. In fact, a 19% reduction in consumption would hold an average residential customer harmless from the rate increase. Likewise, any reduction in usage of less than 19% will still serve to proportionally diminish the magnitude of the increase an individual customer will experience. The

¹ See Appendix II for the specific details of incremental DSM expenditures.

1 additional DSM expenditures will provide customers with the knowledge,
2 tools, and program vehicles to practice energy savings, and in turn control
3 the impact of the rate increase.
4

5 Q. Please continue.

6 A. The modification to reflect a 10/90 shareholder/ratepayer sharing of any
7 savings realized through the renegotiation of the Pinnacle West power
8 supply contract will allow customers to realize a greater portion of any
9 saving, while at the same time preserve UniSource's incentive to
10 renegotiate the contract to more favorable terms. Under the Parties'
11 agreement as it now reads UniSource shareholders would realize 40% of
12 any energy cost savings it could achieve. Presumably this is intended to
13 incent UniSource to negotiate aggressively. While an incentive may be
14 appropriate in this case, the magnitude of the incentive renders this
15 provision more akin to a windfall.
16

17 Q. Please explain.

18 A. Assuming a 40/60 sharing, as provided for in the agreement, and a
19 negotiated 10% reduction in the contract price, UniSource would realize
20 additional profits of over \$3 million a year. This truly represents a windfall
21 considering that absent the 40/60 agreement, ratepayers would be entitled
22 to 100% of any power cost savings. An incentive can be created without
23 the need to provide UniSource with windfall profits. RUCO recommends

1 that an effective, yet equitable, incentive can be created through a 10/90
2 sharing of the savings.
3

4 Q. With these additions and modifications would RUCO support the
5 settlement agreement?

6 A. Yes. With the above discussed modifications and additions RUCO
7 believes the settlement agreement is a reasonable solution for dealing
8 with the impacts of the 2000/2001 dysfunctional energy markets, and
9 accordingly is in the public interest.
10

11 Q. Does this conclude your direct testimony?

12 A. Yes.
13
14
15
16
17
18

APPENDIX I

APPENDIX I

Qualifications of Marylee Diaz Cortez

- EDUCATION:** University of Michigan, Dearborn
B.S.A., Accounting 1989
- CERTIFICATION:** Certified Public Accountant - Michigan
Certified Public Accountant - Arizona
- EXPERIENCE:** Audit Manager
Residential Utility Consumer Office
Phoenix, Arizona 85007
July 1994 - Present

Responsibilities include the audit, review and analysis of public utility companies. Prepare written testimony, schedules, financial statements and spreadsheet models and analyses. Testify and stand cross-examination before Arizona Corporation Commission. Advise and work with outside consultants. Work with attorneys to achieve a coordination between technical issues and policy and legal concerns. Supervise, teach, provide guidance and review the work of subordinate accounting staff.

Senior Rate Analyst
Residential Utility Consumer Office
Phoenix, Arizona 85004
October 1992 - June 1994

Responsibilities included the audit, review and analysis of public utility companies. Prepare written testimony and exhibits. Testify and stand cross-examination before Arizona Corporation Commission. Extensive use of Lotus 123, spreadsheet modeling and financial statement analysis.

Auditor/Regulatory Analyst
Larkin & Associates - Certified Public Accountants
Livonia, Michigan
August 1989 - October 1992

Performed on-site audits and regulatory reviews of public utility companies including gas, electric, telephone, water and sewer throughout the continental United States. Prepared integrated proforma financial statements and rate models for some of the largest public utilities in the United States. Rate models consisted

of anywhere from twenty to one hundred fully integrated schedules. Analyzed financial statements, accounting detail, and identified and developed rate case issues based on this analysis. Prepared written testimony, reports, and briefs. Worked closely with outside legal counsel to achieve coordination of technical accounting issues with policy, procedural and legal concerns. Provided technical assistance to legal counsel at hearings and depositions. Served in a teaching and supervisory capacity to junior members of the firm.

RESUME OF RATE CASE AND REGULATORY PARTICIPATION

<u>Utility Company</u>	<u>Docket No.</u>	<u>Client</u>
Potomac Electric Power Co.	Formal Case No. 889	Peoples Counsel of District of Columbia
Puget Sound Power & Light Co.	Cause No. U-89-2688-T	U.S. Department of Defense - Navy
Northwestern Bell-Minnesota	P-421/EI-89-860	Minnesota Department of Public Service
Florida Power & Light Co.	890319-EI	Florida Office of Public Counsel
Gulf Power Company	890324-EI	Florida Office of Public Counsel
Consumers Power Company	Case No. U-9372	Michigan Coalition Against Unfair Utility Practices
Equitable Gas Company	R-911966	Pennsylvania Public Utilities Commission
Gulf Power Company	891345-EI	Florida Office of Public Counsel

Jersey Central Power & Light	ER881109RJ	New Jersey Department of Public Advocate Division of Rate Counsel
Green Mountain Power Corp.	5428	Vermont Department of Public Service
Systems Energy Resources	ER89-678-000 & EL90-16-000	Mississippi Public Service Commission
El Paso Electric Company	9165	City of El Paso
Long Island Lighting Co.	90-E-1185	New York Consumer Protection Board
Pennsylvania Gas & Water Co.	R-911966	Pennsylvania Office of Consumer Advocate
Southern States Utilities	900329-WS	Florida Office of Public Counsel
Central Vermont Public Service Co.	5491	Vermont Department of Public Service
Detroit Edison Company	Case No. U-9499	City of Novi
Systems Energy Resources	FA-89-28-000	Mississippi Public Service Commission
Green Mountain Power Corp.	5532	Vermont Department of Public Service
United Cities Gas Company	176-717-U	Kansas Corporation Commission

General Development Utilities	911030-WS & 911067-WS	Florida Office of Public Counsel
Hawaiian Electric Company	6998	U.S. Department of Defense - Navy
Indiana Gas Company	Cause No. 39353	Indiana Office of Consumer Counselor
Pennsylvania American Water Co.	R-00922428	Pennsylvania Office of Consumer Advocate
Wheeling Power Co.	Case No. 90-243-E-42T	West Virginia Public Service Commission Consumer Advocate Division
Jersey Central Power & Light Co.	EM89110888	New Jersey Department of Public Advocate Division of Rate Counsel
Golden Shores Water Co.	U-1815-92-200	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-92-135	Residential Utility Consumer Office
Sulphur Springs Valley Electric Cooperative	U-1575-92-220	Residential Utility Consumer Office
North Mohave Valley Corporation	U-2259-92-318	Residential Utility Consumer Office
Graham County Electric Cooperative	U-1749-92-298	Residential Utility Consumer Office

Graham County Utilities	U-2527-92-303	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-93-110	Residential Utility Consumer Office
Litchfield Park Service Co.	U-1427-93-156 & U-1428-93-156	Residential Utility Consumer Office
Pima Utility Company	U-2199-93-221 & U-2199-93-222	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-94-306	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-182	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-310 & U-1303-94-401	Residential Utility Consumer Office
Pima Utility Company	U-2199-94-439	Residential Utility Consumer Office
SaddleBrooke Development Co.	U-2492-94-448	Residential Utility Consumer Office
Boulders Carefree Sewer Corp.	U-2361-95-007	Residential Utility Consumer Office
Rio Rico Utilities	U-2676-95-262	Residential Utility Consumer Office
Rancho Vistoso Water	U-2342-95-334	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-95-491	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-473	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-417 et al.	Residential Utility Consumer Office

Paradise Valley Water	U-1303-96-283 & U-1303-95-493	Residential Utility Consumer Office
Far West Water	U-2073-96-531	Residential Utility Consumer Office
Southwest Gas Corporation	U-1551-96-596	Residential Utility Consumer Office
Arizona Telephone Company	T-2063A-97-329	Residential Utility Consumer Office
Far West Water Rehearing	W-0273A-96-0531	Residential Utility Consumer Office
SaddleBrooke Utility Company	W-02849A-97-0383	Residential Utility Consumer Office
Vail Water Company	W-01651A-97-0539 & W-01651B-97-0676	Residential Utility Consumer Office
Black Mountain Gas Company Northern States Power Company	G-01970A-98-0017 G-03493A-98-0017	Residential Utility Consumer Office
Paradise Valley Water Company Mummy Mountain Water Company	W-01303A-98-0678 W-01342A-98-0678	Residential Utility Consumer Office
Bermuda Water Company	W-01812A-98-0390	Residential Utility Consumer Office
Bella Vista Water Company Nicksville Water Company	W-02465A-98-0458 W-01602A-98-0458	Residential Utility Consumer Office
Paradise Valley Water Company	W-01303A-98-0507	Residential Utility Consumer Office
Pima Utility Company	SW-02199A-98-0578	Residential Utility Consumer Office
Far West Water & Sewer Company	WS-03478A-99-0144 Interim Rates	Residential Utility Consumer Office
Vail Water Company	W-01651B-99-0355 Interim Rates	Residential Utility Consumer Office

Far West Water & Sewer Company	WS-03478A-99-0144	Residential Utility Consumer Office
Sun City Water and Sun City West	W-01656A-98-0577 & SW-02334A-98-0577	Residential Utility Consumer Office
Southwest Gas Corporation ONEOK, Inc.	G-01551A-99-0112 G-03713A-99-0112	Residential Utility Consumer Office
Table Top Telephone	T-02724A-99-0595	Residential Utility Consumer Office
U S West Communications Citizens Utilities Company	T-01051B-99-0737 T-01954B-99-0737	Residential Utility Consumer Office
Citizens Utilities Company	E-01032C-98-0474	Residential Utility Consumer Office
Southwest Gas Corporation	G-01551A-00-0309 & G-01551A-00-0127	Residential Utility Consumer Office
Southwestern Telephone Company	T-01072B-00-0379	Residential Utility Consumer Office
Arizona Water Company	W-01445A-00-0962	Residential Utility Consumer Office
Litchfield Park Service Company	W-01427A-01-0487 & SW-01428A-01-0487	Residential Utility Consumer Office
Bella Vista Water Co., Inc.	W-02465A-01-0776	Residential Utility Consumer Office
Generic Proceedings Concerning Electric Restructuring Issues	E-00000A-02-0051	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-02-0707	Residential Utility Consumer Office
Qwest Corporation	RT-00000F-02-0271	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-02-0403	Residential Utility Consumer Office

APPENDIX

II

APPENDIX II

RECOMMENDED INCREMENTAL DSM PROGRAMS AND FUNDING

- * Unisource shall increase funding for DSM programs in the existing Citizens Utilities service territory by \$825,000 annually from the current level of \$175,000 annually to a total of \$1,000,000 annually. The incremental \$825,000 will be eligible for deferral and potential future recovery from ratepayers, subject to rapid deployment and successful implementation of programs. Deferrals will accrue interest at the Company's authorized cost of capital.
- * Of the total funding of \$1,000,000, \$400,000 will be contingent on the renegotiation and reduction in the APS contract power rate. \$600,000 of the DSM funding is assured, no matter what.
- * The DSM programs include additional funding for the following existing Citizens Utilities programs:
 - Residential/Commercial Education
 - Residential Incentives
 - Commercial HVAC
 - New Construction
 - Web-Based Energy Audit
- * The following new programs would be added with the additional funding:
 - Shade Trees Program
 - Weatherization
 - Commercial Lighting
 - Commercial Motors

- * All program designs will be subject to the preapproval process that was in place for Citizens electric DSM programs prior to Decision No. 59951.